support, toll to local service support, and business to residential support.

2. Ensure a level playing field for competing carriers.

3. Ensure the interoperability of a variety of equipment and services through requiring the adherence of nationally recognized technological standards.

G. **Utilize governmental and regulatory structure to manage the transition to a competitive marketplace in the public interest.**

1. Implement policies that foster competition while preserving the "social contract" of universal service.

2. Focus on consumer activities and consumer protection. As an area develops competition, public policy should rely on market forces and regulation should be phased out. Non-competitive universal services should be subject to continued regulation of all telecommunications providers offering services contained in the universal service "social contract" definition.

H. **Foster partnerships and alliances among state and local governments, educational institutions and private industry for the rapid deployment of information and telecommunications infrastructure.**

1. Establish a Telecommunications Advisory Council whose membership shall include service users and providers with equal representation from state government, state regulators and telecommunications providers to provide aid to the Office of Telecommunications and the Public Service Commission in the implementation of the above recommendations.

2. Provide assistance to user groups in securing Federal and State grants enabling connection to the telecommunications infrastructure expeditiously.

3. In cases where competitive incentives are not great enough, the state should provide a leadership role in pilot programs as, for example, in telemedicine and use of the Internet for K-12 education.

4. Maintain a comprehensive telecommunications infrastructure database to assist in the state's economic development activities.

LA RCC # 1

Before

LOUISIANA PUBLIC SERVICE COMMISSION

DOCKET U-17826

Investigation Dealing with the Public Need to Continue Regulation of Radio Common Carriers as Described in L.R.S. 45:1500-1503

TESTIMONY OF

WALTER G. BOLTER

AND

JAMES W. MCCONNAUGHEY

On Behalf of

LOUISIANA ASSOCIATION OF RADIO COMMON CARRIERS

February 1988

EXHIBIT

48

Executive Summary

Q. COULD YOU PLEASE SUMMARIZE YOUR BACKGROUND AND TESTIMONY?

A. Yes. As the attached testimony describes in greater detail, Bethesda Research Institute, Ltd. (BRI) has appeared in well over 30 states on the subject of telecommunications regulatory and policy matters. Many of these appearances have been on behalf of State regulatory commissions considering economic and competitive telecommunications issues, such as entry regulation. We have also appeared before Congress and Canadian authorities, and in Great Britain to discuss such issues as competition and deregulation in the industry. Our testimony, on behalf of the Louisiana Association of Radio Common Carriers in this case, shows that continued surveillance of the industry, and particularly entry regulation, is critical to the public interest.

Specifically, continued regulation is critical because:

1) Experience in Louisiana (and nationally) shows that wireline telephone company basic service customers may pay higher rates due to cost shifts and if regulation is lifted;

2) Rural areas currently served are in danger of being left without service;

3) Ratepayers of mobile service providers (Radio Common Carriers or "RCCs") may also ultimately pay higher rates due to cost shifts;

4) Existing RCCs may be forced out of business, exacerbating the economic downturn from which the State suffers.

In order to appreciate the likelihood that these events will occur, it is necessary to understand a few basic facts about the telephone industry.

RCCs provide a variety of mobile services to the public. Mobile services are generally known as mobile telephone/radio (two-way) and paging one-way services. In two-way mobile telephone service, an individual with a mobile telephone can place calls to and receive calls from subscribers of the land line telephone system. Paging is a one-way communications achieved by one person placing a call to a centrally located transmitter which, in turn, activates a receiver (commonly called a "pager" or "beeper") carried by another individual. As this industry continues to grow, it promises to provide new and innovative telecommunications services at low costs. Mobile radio services are critically dependent upon local (wireline) telephone companies, such as South Central Bell, for interconnecting the RCCs' pagers with the local telephone network. This means that even "slight" delays or other problems in interconnection, or differences in rates, can have disproportionate effects on competition; this is especially true where telephone companies are competitors with the RCCs for pagers and mobile telephone services.

Because of past experience in Louisiana, and indeed nationally, this Commission must play a central and crucial role to ensure that this market continues to realize its fullest potential for serving the public interest and that competition is not diminished by discriminatory telephone company practices.

Specifically, the attached testimony describes our examination of the paging and mobile telephone services market in Louisiana. A fundamental reason requiring continued entry regulation involves the preservation of service to areas which might otherwise go without service. As may be seen from experience in the deregulated airline industry, entry deregulation can also spell the end of exit regulation -- and the end of the public's assurance that service to smaller communities will not be abandoned in favor of the profits available in large cities. The application of this principle to the RCC industry is not abstract--it is real. For instance, the FCC has currently allocated approximately 70 paging frequencies for use by providers of mobile services. Were barriers to entry to be lifted by the Commission, it is highly unlikely that any number of competitors could survive for long in Louisiana cities like Alexandria, Shreveport, Lafayette and Monroe and certainly not in the rural areas, which are marginally profitable at best. The bankruptcy and accompanying departure from the marketplace of these firms may not only leave many customers without service, but may also destroy currently viable RCCs who have made good faith investments to serve the public based upon long standing principles of entry regulation. Indeed, as the testimony indicates, the Louisiana Public Service Commission has historically employed its entry regulation to prevent further deterioration of the state's motor carrier industry.

As the Commission is well aware, the Commission, pursuant to State statute, regulates the market entry for motor carriers operating within the State's boundaries. The statute explicitly provides that the Commission, before granting market entry to a new motor carrier, must assess the economic conditions of the industry and the impact that a new carrier would have on the existing carriers. If the Commission considers the economic impact for motor carriers, it would seem logical that it should also continue to assess such impact for RCCs.

A second basic reason for continued entry regulation of the RCC market centers on an unfair practice, known as cost shifting or "cross subsidy" by economists, which has apparently already occurred and may well grow worse without this Commission's oversight. Telephone company cross subsidy occurs when telephone companies use their regulated operations to, in essence, pay for the costs of competing in nonmonopoly markets such as paging. In other words, the telephone companies use the revenues from their telephone operations to subsidize the cost of operating their paging services. This is obviously harmful to firms which have no protected monopolies, such as RCCs, from which to extract funds, and eventually leads to market dominance by the cross subsidizing firm. This outcome not only results in higher costs for the customers of the market in which competition has been diminished, but it also results in higher rates for the telephone company ratepayers who have had to bear costs having no direct and causal relation to the service provided.

For these reasons, entry regulation is the bedrock principle upon which many of today's regulatory policies are founded.

As discussed earlier and in the testimony that follows, cross subsidization of paging mobile telephone services by a Louisiana telephone company at the expense of general ratepayers has been documented (see Exhibit 3 below). In view of this activity and the increasing presence of local telephone companies in traditional RCC markets, the possibility of market power abuses in Louisiana's mobile services market is not mere conjecture.

As the testimony also indicates in detail, these same concerns with telephone company cross subsidy exist at the national level. Among the key governmental officials and public policy makers who have documented telephone company cross subsidy -- either potential and/or actual -- are Federal District Court Judge Harold Greene, the National Association of State Regulatory Utility Commissioners (to which this Commission belongs), and Congress. Of particular note, is Judge Greene's finding only several months ago (September 10, 1987) that the Regional Bell Companies appeared to have consistently funded their competitive operations with local phone rates.

For all of these reasons, discussed in the detailed testimony below, general deregulation and specifically open entry into Louisiana's RCC markets seems ill-advised at this time.

Q. PLEASE STATE YOUR NAME, BUSINESS AFFILIATION, AND ADDRESS.

A. Walter G. Bolter, who is the Director of the Bethesda Research Institute, Ltd. (BRI) located at 751 Rockville Pike, Rockville, Maryland 20852; and James W. McConnaughey, Manager, Research Studies Division, at the same location as Dr. Bolter.

As a member of the research community, the Institute provides independent research, analysis, and other services in various sectors, particularly telecommunications. The firm specializes in matters related to economics, technology, accounting, and finance, especially as they impact major areas of public policy.

We have appeared in over 30 states before state regulatory commissions, courts and state legislatures on the subject of telecommunications regulatory and policy matters. Many of these appearances have been on behalf of state regulatory commissions who have been considering economic and competitive telecommunications issues, such as entry regulation. Representatives of BRI have also appeared before Congress and in Great Britain on telecommunications or related matters. Our academic backgrounds and professional qualifications are contained in more detail in Appendix A.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. We have been retained by the Louisiana Association of Radio Common Carriers to provide testimony to assist this Commission in its consideration of the regulation of Radio Common Carriers ("RCCs") in the State of Louisiana. Since 1968, this Commission has regulated the rates and entry into the business of RCCs. Basically, competitive entry into the Louisiana mobile telephone service market can have significant adverse effects upon the public, given existing conditions in the sector. The purpose of this testimony is to examine these underlying characteristics in light of documents provided by counsel which we have examined unique to the Louisiana RCC market and in light of perspectives gained elsewhere.

Q. UPON WHAT BASIS DO YOU CONCLUDE THAT COMPETITIVE ENTRY INTO THE LOUISIANA RCC MARKET WOULD BE ADVERSE TO THE PUBLIC INTEREST?

A. In a nutshell, unregulated and un fettered entry into the marketplace would unleash the market power of large firms, such as local telephone (wireline) companies, to potentially shift costs. This could force the wireline's profitable business operations to pay for its competitive operations. These competitive operations include mobile services, such as two-way radio and paging services, which are also provided by nontelephone company RCCs. The RCCs would face a heavy burden in meeting the rates of underpriced wireline mobile services due to this cost shifting to the telephone company's regulated monopoly operations. Unregulated entry may also allow nonwireline carrier firms having market power to enter. Subsequently, they could anticompetitively price their mobile services by cost shifting as well. Economists refer to this practice as "cross subsidization;" it must be avoided so that other suppliers in the mobile services market are not unfairly disadvantaged or even driven out.

In addition, dislocations and a "shakeout" could beset the RCC industry. Eliminating exit regulation could result in loss of service to rural users and idle investment capacity for displaced or weakened providers. Open entry could attract national firms whose service focus could be transferred from the local community to the nearest urban center or even a regional locus. Such activity could be debilitating to an already depressed State economy. For this reason, entry regulation has become virtually the cornerstone of today's regulatory policies.

Q. WHAT PARTICULAR FACTS LEAD YOU TO CONCLUDE THAT THIS

PHENOMENON KNOWN AS CROSS SUBSIDY WILL OCCUR IN LOUISIANA?

A. To demonstrate that these conditions are present if open entry is allowed, it is necessary to discuss the telecommunications market generally.

Local telephone service in Louisiana is the province of 21 LECs. 1/ South Central Bell is the dominant local presence in the State, serving 1,729,606 company owned access lines (90.1 percent of the State total) and some 33,735 square miles (69.5 percent of the State's geographical area). Other major wireline carriers, also known as local exchange carriers (LECs) in the State include Century Telephone Enterprises, Inc., a holding company operating ten local companies in Louisiana which provide 71,943 (3.8 percent) access lines covering over 13 percent of the State's area; and East Ascension Telephone Co. (19,166 or 1.0 percent of company owned access lines; 479 square miles or 1.0 percent of the State). 2/ Of course, each LEC in its own service area is a franchised monopoly and

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1/ Source: U.S. Telephone Association (December 31, 1986 data). See 1987/88 Telephone Engineer & Management Directory, p. 643.

2/ Id.; USTA, Annual Statistical Vol. 2, 1987, pp. 29, 35, 47, 54, 78, 86, 113, 120, 138, 159; NTIA, Telephone Area Serviced by Bell and Independent Companies in the United States, Report 82-97, pp. 2, 4, 9, 90 (January 1, 1981 data).

possesses certain substantial market power in that realm.

The State's mobile telephone service market has several major elements. Under the regime originally established by the FCC, one wireline carrier and one nonwireline company have been permitted to serve each designated cellular market. In Louisiana's two largest designated cellular markets, New Orleans (number 29 in the country) and Baton Rouge (number 80), BellSouth Mobility Inc. (BMI) is the principal wireline service provider and is an affiliate of South Central Bell. In the third major market, Shreveport (number 100), Century Telephone Enterprises is the principal wireline presence. The FCC regulates entry of cellular providers (originally through comparative hearings and subsequently by a lottery selection process) while other aspects may be regulated by the respective State PSCs.

More traditional, noncellular mobile radio service has been available in Louisiana for a number of years. Radio common carriers (RCCs) are common carriers engaged in the provision of Public Mobile Service and which are also not in the business of providing landline local exchange telephone service. The RCCs have been regulated in the State since 1968. In 1986 thirteen RCCs, including Radiofone, Inc., provided service in specified areas. PSC regulation of RCCs relates to issuance of certificates of public convenience and necessity (CPC&N), authorization of tariffs, approval of rates, determination of conditions of service, and review of financing. The FCC, of course, regulates the use of all radio spectrum and approves operating licenses and construction permits for RCCs.

Regulation of intrastate RCC operations (e.g., entry) is the jurisdiction of State commissions as affirmed on March 30, 1987 by the U.S. Court of Appeals for the District of Columbia. 3/ As set forth in the "RCC Statute" in Louisiana, *viz.*, Revised Statutes 5.12:1500 *et seq.*, the PSC regulates entry of RCCs providing conventional (one-way) paging or "beeper" services and two-way mobile services in the Public Land Mobile Service. Although exclusive service areas are frequently assigned by the PSC to RCCs, the agency may permit additional entities to furnish mobile service in these areas. More specifically, Section 1503(c) of the RCC Statute states:

> The commission shall not grant a certificate for a proposed radio common carrier operation or extension thereof which will be in competition with or duplication of any other radio common carrier unless it shall first determine that the existing service is inadequate

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3/ *Per curiam* Order, *NARUC* v. *Federal Communications*, No. 86-1205, vacating FCC Report and Order, CC Docket No. 85-89, FCC 86-112 (released March 31, 1986).

> to meet the reasonable needs of the public and that the person operating the same is unable to or refuses or neglects after hearing on reasonable notice to provide reasonable adequate service.

Historically, local exchange carriers that seek to provide Public Land Mobile Service have been regulated pursuant to <u>La. Const.</u>, art. 4 S.21 and are expressly excluded from the aegis of the RCC Statute, L.R.S. Sec. 45:1501(D). LECs operate radio facilities within their respective assigned service areas without being required to seek a certificate of public convenience and necessity. In Order No. U-13727, the PSC determined that where a land line telephone company (i.e., LEC) seeks to operate land mobile communications equipment outside of its geographical service area, a CPC&N from the Commission would be required (<u>Radiofone</u> v. <u>Lafourche Telephone Company</u>, April 19, 1979).

Subsequently this demarcation has become more complex. In Order Nos. U-14506 and 14506A (the <u>Cameron</u> case) and U-14645 (the <u>Kaplan Telephone Company</u> case), the PSC has ruled that the effective range of an LEC's radio-telephone transmission tower, rather than its landline boundary, is the proper standard for defining the service area of a radio-telephone system operated in conjunction with a landline telephone system. The LEC's transmitting tower built henceforth would necessarily be located at an exchange office in close proximity thereto, with existing towers in operation and (only) their existing services to be "grandfathered." The Cameron and Kaplan decisions were eventually upheld by the Supreme Court of Louisiana on October 17, 1983.

Thus, as LECs have been permitted to provide service in a manner that increasingly brings them into competition with RCCs, the issue of cross subsidization has gained new importance for public policy makers.

Q. HAS CROSS SUBSIDIZATION BY LECs OCCURRED IN LOUISIANA? HAS IT TRANSPIRED SPECIFICALLY IN THE PUBLIC LAND MOBILE RADIO SERVICE MARKET?

A. Apparently, yes. One of the aforementioned Bell regional company audits by NARUC focused on the BellSouth corporate family which includes, inter alia, South Central Bell (SCB). Among the task force's findings were the apparent existence of a "great deal of service and function duplication within the corporation." 4/ For example, BellSouth Corporation provides strategic technical and marketing planning for which the ratepayers of South Central Bell and Southern Bell may be paying excessively for this function. In addi-

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4/ NARUC, Summary Report on the Regional Holding Company Investigations, op. cit., p. 15.

tion, it was noted that the BellSouth Advertising and Publishing Company (BAPCO) could not substantiate that the affiliated telephone companies were receiving the same revenue contribution as before the formation of BAPCO. Another concern raised was that of the operating companies' association with Bellcore, especially with respect to the accounting for expenses. 5/ Compounding these concerns was the restricted access to records of the regional company and its affiliates, which is viewed by regulators as an "area where extreme difficulty will surround future regulatory audits by the nine jurisdictions of BellSouth." 6/ Thus, as part of the BellSouth family, SCB in Louisiana has apparently experienced questionable cost and revenue transfers involving other affiliates.

More specifically, Louisiana landline carriers have also seemingly engaged in cross subsidy relating to their mobile radio telephone offerings. As documented in Radiofone v. Lafourche, the LEC attempted to cross subsidize its paging operations through its landline business. In CC Docket Nos. 79-250 and 79-251 before the FCC, evidence was adduced that at least in the early 1970s South Central Bell's ". . . general

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5/ Id., pp. 15, 16.

6/ NARUC, Audit Report on BellSouth, Inc., July 11, 1986, p. 88.

subscriber body [was] subsidizing mobile" (see Exhibit 3).

Overall, then, some local exchange carriers in the State apparently may have engaged in cross subsidization activities in various areas, including specifically their mobile radio operations.

Q. IS THERE ANY INDICATION THAT LECs IN THE STATE WILL HAVE EITHER THE MEANS OR THE DESIRE TO CROSS SUBSIDIZE SUCH BUSINESSES AS MOBILE TELEPHONY OR PAGING IN THE FUTURE?

A. Yes. There is no evidence that the local monopoly base for any of the State's LECs will erode significantly in the foreseeable future. Moreover, it is not evident that the incipient FCC accounting -- auditing system will be able to preclude anticompetitive cost or revenue shifts from occurring, especially if the Commission devotes inadequate oversight resources to the task.

In particular, BellSouth interests in the State will apparently have the wherewithal and potentially the incentive to engage in such dubious cost shifting. Thus, as can be gleaned from Exhibit 1, BellSouth is the top rated LEC-based telecommunications company in the U.S. in terms of market value and second only to

AT&T overall in the rankings. In 1985 the entity had $25 billion in assets and generated a profit margin on sales (13.3 percent) that surpassed the average margin for both the top 1,000 U.S. corporations (4.5 percent) <u>and</u> all Bell regional companies as a group (11.9 percent). 7/ BellSouth's Chairman and Chief executive Officer has made it clear that SCB and Southern Bell have a pivotal role to play in the regional's future:

> While BellSouth Enterprises, with its 16 subsidiaries and joint ventures, is the 'key to BellSouth's long-term growth,' the 'two powerhouses' in the BellSouth Corp. family of companies are the two telephone operating companies . . . a 'firm foundation for the future'. . . 8/

Similar to the other Bell regional companies, BellSouth has vigorously sought to diversify. Among its ventures approved by Judge Greene are ones concerning cellular (detailed below), financial services, advertising, nontariffed billing services, office equipment, real estate, print media, software, training and education, and foreign ventures. The two local operating companies have also received permission to enter such businesses as nontariffed billing services and software.

7/ <u>Business Week</u> data.

8/ "Clendenin tells financial analysts telcos represent 'firm foundation for the future,' <u>Telecommunications Reports</u>, June 1, 1987, p. 15.

That BellSouth is specifically interested in aggressively pursuing the mobile telephone service market is widely documented. Besides its strong presence in Louisiana's two largest cellular markets and numerous other major cities in the South, the regional company recently proposed to acquire Mobile Communications Corp. of America (MCCA), a major nonwireline provider of cellular telephone and electronic paging services. Although the company withdrew its reportedly $564 million offer because it was outbid, BellSouth's interest in the business seems undeniable. Moreover, BellSouth has requested and been permitted by the MFJ court to initiate such businesses as cellular monitoring and consulting services, foreign cellular ventures, and out-of-region cellular and paging.

Furthermore, as observed by Judge Greene (see Appendix B), the potential for cross subsidization in markets where common cost allocations "can be attributed, almost at the companies' unfettered choice" is much greater than between exchange service and "ventures foreign to telecommunications." This is so ". . . if only because cross subsidies are much more easily concealed . . ."

Q. GIVEN YOUR ANALYSIS, HOW DO YOU VIEW THE PSC'S ORDER IN DOCKET NO. U-16526?

A. The decision has potentially important implications for the provision of mobile telephone service in Louisiana. In that case, Cameron Telephone Company was permitted to provide paging services in South Central Bell's exchange area. Cameron, not SCB, was awarded the paging frequencies in the Lake Charles area by the FCC via lottery even though that exchange area is served by SCB. Moreover, the incumbent RCC was found to be lacking in its provision of reliable paging services for that geographic area.

Notably, the precedent of allowing one landline carrier to provide mobile telephone service in another LEC's service area <u>without</u> obtaining a certificate (i.e., CPC&N) may be a significant cause for concern. This clearly broadens the policy scope of <u>Kaplan</u> and the original <u>Cameron</u> decisions considerably beyond the spirit of the "transmitter range" criterion set forth therein. It also expands the reach of the "inadequate service" provision of Sec. 1503(c) of the RCC Statute by not requiring a CPC&N. Some may view these actions as the inauguration of the dismantling of the PSC's traditional regulatory approach. If they do signal the beginning of the unregulated provision of mobile services by local telephone companies virtually anywhere in the State, then these recent decisions should properly be regarded with considerable alarm, given the above referenced ability of these local carriers to cross subsidize.

Many economists are generally advocates of entry as a positive influence on the competitiveness of a given market. And, this approach can be a sound one depending on the specific facts of the situation. However, where entry is achieved through admission of a firm exhibiting insufficiently bridled market power into a market whose incumbent possesses no such power base, the long term efficacy of pursuing this policy should be more carefully considered. Indeed, given these implications and the myriad of cross subsidy concerns discussed *supra*, the wisdom of this pursuit may be quite suspect. In cases where geographic proximity (as well as Greene's common-cost concerns) obtain, the subsidization problem would be exacerbated. Clearly, under this scenario, entry by a dominant firm for the sake of entry would be ill-advised without adequate safeguards.

Q. IN ADDITION TO THE EVIDENCE THAT YOU HAVE DISCUSSED INDICATING THAT CROSS SUBSIDIZATION HAS OCCURRED, AND MAY OCCUR TO A GREATER EXTENT ABSENT ENTRY REGULATION BY THE LOUISIANA PUBLIC SERVICE COMMISSION, IS THERE OTHER EVIDENCE WHICH SUGGESTS THAT TELEPHONE COMPANY CROSS SUBSIDY IS A REAL THREAT?

A. Yes. Since telephone company cross subsidy is largely a function of market power, and the consequent ability to channel monopoly power into competitive markets, the ability to cross subsidize is inferred at least in part by the existence of that market power. There is much evidence at the national level that market power continues to be possessed by the telephone industry--and in particular the Bell companies. Similar evidence indicates that cross subsidization has occurred, and will continue to occur if Bell companies are allowed into more competitive markets. This evidence is compelling and voluminous; because of its somewhat technical nature, we have included a narrative discussion on this point in Appendix B to this testimony.

Q. IS THERE A SIMILARLY REGULATED SECTOR IN LOUISIANA WHOSE EXPERIENCE MAY PROVE INSIGHTFUL FOR THE STATE'S RADIO COMMON CARRIER MARKET?

A. Yes. The intrastate trucking industry is currently regulated by the Louisiana Public Service Commission pursuant to Title 45 of the Louisiana Revised Statutes, Sections 161 <u>et</u> <u>seq</u>. The PSC is charged, <u>inter alia</u>, with "reasonable and just regulation of this business . . . to conserve the interest of the general public" and to "foster sound economic conditions among all classes of carriers" (Sec. 161, "Declaration of policy"). A certificate of public convenience and